

ILLINOIS REGISTER
DEPARTMENT OF REVENUE
NOTICE OF PROPOSED AMENDMENT

- 1) Heading of the Part: Income Tax
- 2) Code Citation: 86 Ill. Adm. Code 100
- 3) Section Number: 100.2406 Proposed Action: New Section
- 4) Statutory Authority: 35 ILCS 5/203(a)(2)(A), 203(b)(2)(A), 203(c)(2)(A), 203(d)(2)(A) and 1401
- 5) A Complete Description of the Subjects and Issues Involved: This rulemaking provides guidance on the addition modification taxpayers must make in computing their base income for certain interest and dividends excluded from federal income taxation.
- 6) Published studies or reports and sources of underlying data used to compose this rulemaking: None
- 7) Will this rulemaking replace any emergency rulemaking currently in effect? No
- 8) Does this rulemaking contain an automatic repeal date? No
- 9) Does this rulemaking contain incorporations by reference? No
- 10) Are there any other proposed rulemakings pending on this Part? Yes

<u>Section Number</u>	<u>Proposed Action</u>	<u>IL Register Citation</u>
100.2470	Amendment	31 Ill. Reg. 12296; 08/24/07
100.2185	Amendment	31 Ill. Reg. 12449; 08/31/07
100.7110	Amendment	31 Ill. Reg. 12670; 09/07/07
100.2110	Amendment	31 Ill. Reg. 13086; 09/14/07
100.2160	Amendment	31 Ill. Reg. 13331; 09/21/07
100.5070	New Section	31 Ill. Reg. 13697; 10/05/07
100.5080	New Section	31 Ill. Reg. 13697; 10/05/07
100.2197	Amendment	31 Ill. Reg. 14217, 10/11/07
- 11) Statement of Statewide Policy Objective: This rulemaking does not create a State mandate, nor does it modify any existing State mandates.
- 12) Time, Place and Manner in which interested persons may comment on this rulemaking: Persons who wish to submit comments on this rulemaking may submit them in writing by no later than 45 days after publication of this Notice to:

Paul Caselton
Deputy General Counsel - Income Tax
Illinois Department of Revenue
Legal Services Office
101 West Jefferson
Springfield, Illinois 62794

13) Initial Regulatory Flexibility Analysis:

- A) Types of small businesses, small municipalities and not-for-profit corporations affected: Small businesses will receive guidance on the addition modification required for certain interest and dividends exempted from federal income tax. Municipalities and tax-exempt organizations are not affected.
- B) Reporting, bookkeeping or other procedures required for compliance: None
- C) Types of professional skills necessary for compliance: None

14) Regulatory Agenda on which this rulemaking was summarized: July 2007

The full text of the Proposed Amendment begins on the next page:

SUBPART E: ADDITIONS TO AND SUBTRACTIONS FROM TAXABLE INCOME OF INDIVIDUALS, CORPORATIONS, TRUSTS AND ESTATES AND PARTNERSHIPS

Section 100.2406 Addition Modification: Interest and Dividends Paid or Accrued to Taxpayer But Not Included in Taxpayer's Adjusted Gross Income or Taxable Income (IITA Sections 203(a)(2)(A), 203(b)(2)(A), 203(c)(2)(A) and 203(d)(2)(A))

- a) Scope. IITA Section 203 requires all taxpayers to add back to their adjusted gross income or taxable income *an amount equal to all amounts paid or accrued to the taxpayer as interest and dividends during the taxable year to the extent excluded from gross income* in the computation of adjusted gross income or taxable income.
 - 1) Individual taxpayers. Individuals are required to add back federally tax-exempt interest and dividend income. Individuals are not required to add back stock dividends of qualified public utilities excluded from gross income under IRC Section 305(e) (as in effect prior to its repeal by the Omnibus Budget Reconciliation Act of 1990, Public Law 101-508), which applied to distributions made prior to January 1, 1986. IITA Section 203(a)(2)(A).
 - 2) Corporate taxpayers. Corporations (including Subchapter S corporations) are required to add back federally tax-exempt interest and, for taxable years ending on or after December 31, 1987, all tax-exempt interest distributions received as a shareholder in a regulated investment company. IITA Section 203(b)(2)(A) (as amended by Public Act 85-731).
 - 3) Trusts and estates. Trusts and estates are required to add back federally tax-exempt interest and dividend income. IITA Section 203(c)(2)(A).
 - 4) Partnerships. Partnerships are required to add back federally tax-exempt interest and dividend income. IITA Section 203(d)(2)(A).
 - 5) Pass-through entities. A shareholder of a Subchapter S corporation, a beneficiary of a trust or an estate, or a partner in a partnership, must add back all

distributive shares of tax-exempt interest or dividends received from the Subchapter S corporation, trust or estate, or partnership to the same extent it would be required to add back those items if it had received them directly.

b) General definitions. The terms "interest" and "dividends" are not defined in the IITA. IITA Section 102 requires that *except as otherwise expressly provided or clearly appearing from the context, any term used in the IITA shall have the same meaning as when used in a comparable context in the United States Internal Revenue Code.*

1) Interest. Interest required to be added back under this section means amounts excluded from gross income under IRC Section 103 or IRC Section 116 prior to its repeal by the Tax Reform Act of 1986, Public Law 99-514.

A) Interest excluded from gross income under IRC Section 103 includes:

i) amounts deducted from "taxable investment income" of a life insurance company under IRC Section 804(a)(2)(A)(i), which, prior to its repeal by the Deficit Reduction Act of 1984, Public Law 98-369, allowed a deduction for "interest which under Section 103 is excluded from gross income." IITA Section 203(b)(3) (prior to amendment by Public Act 88-648);

ii) interest excluded from life insurance gross income under IRC Section 803(a)(3), but not including the policyholders' share of tax-exempt interest treated as gross income under IRC Section 807(a)(2)(B) or (b)(1)(B); and

iii) amounts deducted from "taxable investment income" of a non-life insurance company under IRC Section 822(c)(1) (prior to redesignation by the Tax Reform Act of 1986 (Public Law 99-514)) or IRC Section 834(c)(1)(after redesignation by the Tax Reform Act of 1986 (Public Law 99-514)), which allow a deduction for "interest which under Section 103 is excluded from gross income."

B) In determining the amount of interest to be added back to Illinois taxable income, the taxpayer must include in income the same portion of accrued original issue discount interest each year in calculating Illinois base income as the taxpayer would be required to include in federal gross income under IRC Section 1272 and Treas. Reg. Section 1.1232-3A were that interest subject to federal tax.

C) Taxpayers who purchase federally tax-exempt bonds at a discount must compute this addition modification using the rules prescribed in IRC Section 1288 by accruing the discount as interest income.

2) Dividends. Dividends required to be added back under this section are dividends excluded from gross income under IRC Section 116 prior to its repeal by the Tax Reform Act of 1986, Public Law 99-514 and "exempt interest dividends" received from a regulated investment company and excluded from adjusted gross income under IRC Section 852(b)(5)(B). IITA Section 203(a)(2)(A) provides that individuals do not have to add back stock dividends excluded under IRC Section 305(e). Accordingly, estates and trusts must add back dividends excluded under IRC Section 305(e).

- 3) Interest and dividends required to be added back under this section do not include amounts excluded from gross income under a provision of the IRC that excludes or exempts from taxation a category of income that includes items other than interest and dividends. For example, under IRC Section 871(b)(2), gross income of a nonresident alien does not include any income from sources outside the United States. Interest and dividends received by a nonresident alien that are excludible from gross income because they are from sources outside the United States are not required to be added back under this section.

(Source: Added at 32 Ill. Reg. _____, effective _____)